



A report by:

THE JOINT LEGISLATIVE STAFF
TASK FORCE ON GOVERNMENT OVERSIGHT

Prepared for:

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JOINT LEGISLATIVE AUDIT COMMITTEE

EDD

*Illegally charges interest
on tax penalties.*



EDD'S PRACTICE OF ILLEGALLY CHARGING INTEREST ON PENALTY ASSESSMENTS

FINDINGS:

1. Without statutory authority the Employment Development Department (EDD) has been charging interest on tax delinquency penalties since January 1, 1994.
2. Without statutory authority, EDD has been charging interest on report delinquency penalties. EDD has never had such authority.
3. EDD contends that state law should be amended to retroactively allow interest to be charged on tax delinquency penalties and report delinquency penalties assessed by EDD.
4. EDD has stated that it will not refund interest moneys collected illegally and it has no estimate of the amount that has been overpaid.
5. The amount of potential refunds to California employers is conservatively estimated to total more than \$18 million for the period of January 1, 1990, through December 31, 1997. This refund is for interest illegally charged on nearly \$78.3 million in penalties since January 1, 1990.

BACKGROUND:

EDD is responsible for collecting employment taxes from businesses that employ workers in California. These taxes include unemployment insurance contributions and the employment training tax, both paid by employers; and disability insurance contributions and personal income taxes, both withheld from employees' pay and remitted to EDD by employers. EDD collects these taxes from employers as frequently as eight times a month or as seldom as annually, depending on the employer.

In addition to paying taxes, EDD requires employers to file quarterly returns reporting wages paid to workers, W-2's, and other reports.

EDD charges two types of penalties for failure to comply with employment tax laws: tax delinquency penalties, assessed for failure to pay taxes in a timely manner; and report delinquency penalties, assessed for failure to file required reports or forms in a timely manner. Additionally, EDD currently charges interest on unpaid taxes and all penalties.

EVOLUTION OF THE LAW:

Interest on Tax Delinquency Penalties:

Prior to 1993, EDD had the authority to charge interest on tax delinquency penalties under Section 19269(b)(3) of the Revenue and Taxation Code (RTC). Senate Bill 3 (Greene, Chapter 31, *Statutes of 1993*) amended various sections of the RTC and eliminated the authority of EDD to charge interest on tax delinquency penalties.

EDD relies on Sections 1113 and 1129 of the UIC for the authority to charge interest on tax delinquency penalties. Under these provisions of law, EDD may charge interest on the taxes themselves, however, in a written opinion of December 12, 1997 (Appendix C), Legislative Counsel states that because of changes in the law, EDD has not had the authority to charge interest on the tax delinquency penalties since January 1, 1994. Specifically, the statutes read:

“1113. Any employer who fails to pay any contributions required of him or his workers, except amounts assessed under Article 8 (commencing with Section 1126), within the time required shall become liable for interest on such contributions at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the date of delinquency until paid.” [Emphasis added]

“1129. The amount of each assessment shall bear interest at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the last day of the month following the close of the calendar quarter, or from and after the 15th day if the month following the close of the calendar month, for which the contributions should have been returned until the date of the payment.”

Interest on Report Delinquency Penalties:

Legislative Counsel also contends that EDD has at no time had the authority to charge interest on report delinquency penalties. The RTC had, until 1994, only allowed EDD to charge interest on tax delinquency penalties. As shown above, Section 1113 allows interest to be charged on “any employer who fails to pay any contributions required.” Report delinquency penalties are charged whether or not there is a tax delinquency. Since interest is to be charged based on a failure to pay taxes, Legislative Counsel holds that Section 1113 does not apply to report delinquency rules, consequently, EDD has never had the authority to charge interest on penalties for delinquent reports.

EDD'S RESPONSE:

In meetings with staff, EDD made clear that it views its lack of authorization to charge interest on tax delinquency penalties as an error in the law. EDD argues that Senate Bill 3 inadvertently removed its authority to charge interest on tax delinquency penalties when it revised the various governing statutes in the RTC, and that the elimination of this authority was unintentional. Therefore, EDD believes the policy of charging interest on these penalties should continue. However, staff could find no reference in any fiscal or policy committee analysis of SB 3, or in the Legislative Counsel Digest that would suggest the Legislature intended to allow EDD to charge interest on tax delinquency penalties or report delinquency penalties. Legislative Counsel contends that when the law is clear on its face, the law must be followed.

EDD stated in meetings with staff that it only became aware of this problem early in 1997. EDD said it would attempt to sponsor legislation which would allow EDD to continue to charge the interest in question.

Staff has asked EDD for the Department's internal analyses of Senate Bill 3 in order to determine when EDD first became aware of the changes regarding its authority. EDD is reviewing whether or not these documents may be made public.

Staff has also asked EDD to respond to the question of charging interest on report delinquency penalties without ever having had the statutory authority to do so.

EDD continues to charge interest on all penalties and has no plan to discontinue charging interest or to issue refunds.

FISCAL IMPACT:

The true fiscal impact of this illegal interest problem can only be determined by a thorough and detailed audit. Because EDD has not had authority to charge interest on tax delinquency penalties from 1994 to present, complete records will exist and an audit should be able to determine the exact amount of interest illegally charged. However, since EDD has never had the authority to charge interest on report delinquency penalties, determining the actual amount illegally charged will likely require an accounting methodology to cover years for which EDD no longer maintains records. The audit should also consider the statute of limitations on EDD's liability for refunds.

EDD was unable to provide information on the amount of interest they have charged without authority on tax and report delinquency penalties. (EDD stated that "some data" may be available by December 22, 1997.) Additionally, EDD was unable to determine the length of time that these penalties have gone unpaid. Therefore, EDD has no estimate of the amount of interest overpaid. EDD did provide numbers for total penalties charged for Fiscal Years 95/96 and 96/97. Staff used these numbers to create an average for the years that EDD has been charging interest without authority.

Staff estimates that interest was illegally charged on penalties of nearly \$78.3 million. The interest charged on these penalties without authority totals more than \$13.4 million. Since refunds should be made with interest, staff estimates that the total refund would be slightly more than \$18 million. (Please see Appendix A for a detailed breakdown of this estimate.) These dollars are EDD Contingent Fund monies. The Contingent Fund is used to support EDD's compliance and enforcement program with any surplus funds transferred to the General Fund.

To determine an estimate of illegal interest charges, staff covered a period from 1990 through 1997. 1990 was chosen because EDD should have maintained complete records back through that year. Using the information EDD was able to provide, staff created an average for the eight years, and a conservative estimate of the amount overcharged. Where no information was provided, staff used averages that EDD has agreed are likely lower than the actual amounts. In all cases of averaging and estimating, staff made no attempt to inflate the numbers, but instead leaned toward underestimation.

Staff estimates were arrived at as follows:

There are several provisions covering penalties upon which EDD has illegally charged interest - Sections 1112, 1112.5 and 1114, and Article 8 of the Unemployment Insurance Code. (EDD stopped charging interest on 1112.5 penalties in 1994.)

1. EDD provided the following Section 1112 penalty data for the last two years (tax delinquency penalty):

<u>Year</u>	<u># of Liabilities</u>	<u>Penalties Charged</u>
95/96	258,004	\$21.3 million
96/97	232,777	\$23.9 million
TOTAL	490,781	\$45.2 million

This amount was averaged at \$22,623,016.48 per year and applied from 1994-1997, the four years EDD has been charging interest without authority.

2. EDD provided the following Section 1112.5 penalty data for the last two years (report delinquency penalty):

<u>Year</u>	<u># of Liabilities</u>	<u>Penalties Charged</u>
95/96	53,308	\$5.1 million
96/97	29,356	\$3.2 million
TOTAL	82,664	\$8.3 million

This amount was averaged at \$4,177,680.59 and applied from 1990-1993. (EDD did stop charging interest under this section after 1993.)

3. Section 1114 penalties (report delinquency penalty) estimated at \$22.6 million charged per year. (Since EDD provided no data on Section 1114, staff used the Section 1112 data above as a basis and EDD agrees that the Section 1114 penalty is likely greater than the amounts charged under Section 1112.)

4. Article 8 penalties (tax delinquency penalties) were estimated by staff based on EDD provided audit assessment data going back to 1994. According to EDD, the audit program has averaged \$80.5 million per year (including penalty and interest) in differences between reported and audited tax liabilities. A rough estimate of the penalty amount included in that total is \$6.2 million.
5. Interest is compounded daily at 8.38% for 1994 through 1997 and 9.63% for 1990 through 1993. (This is an average of interest rates charged since January 1, 1994, through December 31, 1997, and January 1, 1990, through December 31, 1993.)
6. Data is based on the assumption that refunds would be issued as of December 31, 1997.
7. When the illegally charged interest was paid by employers, it was paid within varying periods of time which, based on EDD statistics, were most likely to be as follows:
 - 0 – 90 days 56%
 - 91 – 180 days 18%
 - 180 days – one year 26%

CONCLUSION:

According to Legislative Counsel, the law is clear. The problem to be addressed is EDD's violation of the law. Therefore, the solution is for EDD to correct its procedures to comply with the law.

STAFF RECOMMENDATIONS:

1. EDD should identify all businesses that have been illegally charged interest as discussed above.
2. A complete refund of illegally charged interest should be made to California employers. These refunds should go back at least to January, 1990, and include interest on these overpaid monies. (It is not clear whether EDD has sufficient records to make refunds prior to 1990.)
3. EDD should immediately discontinue the practice of illegally charging interest on penalties.
4. The State Auditor should be asked to complete a performance audit of EDD's Tax Branch to determine the extent of interest being charged without authority and the amount of the refunds to employers. EDD has not agreed that there is a problem with the law, is continuing to charge interest erroneously, and has been slow in providing an estimate of potential refunds.

5. Sections 1113 and 1129 of the UIC should be amended as follows:

“1113. (a) Any employer who fails to pay any contributions required of him or his workers, except amounts assessed under Article 8 (commencing with Section 1126), within the time required shall become liable for interest on such contributions at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the date of delinquency until paid.

(b) Interest charged under this section shall not be charged on penalties charged under this Article.

1129. The amount of each assessment, exclusive of penalty, shall bear interest at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the last day of the month following the close of the calendar quarter, or from and after the 15th day of the month following the close of the calendar month, for which the contributions should have been returned until the date of the payment.”

Contrary to the above suggested language to clarify the existing law prohibition on charging interest on tax penalties, EDD has stated that it intends to *sponsor* legislation in 1998 to amend the law *to allow* interest to be charged on penalties.

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APPENDIX A - Page 1

CALCULATION OF POTENTIAL INTEREST REFUNDS BY EDD 1994-97

Section 1112 UIC Penalty (from EDD)	\$22,623,016.48
Section 1114 UIC Penalty (estimated)	\$22,623,016.00
Article 8 Penalties (estimated)	\$6,222,141.00
TOTAL PENALTY	\$51,468,173.48

TOTAL REFUNDS DUE	Amount
1994 - 1997	\$9,190,539.55
1990 - 1993	\$9,179,822.65
TOTAL	\$18,370,362.19

EDD's Average Annual Interest Rate		8.38%	
1/1/94 - 6/30/94	7%	7/1/94 - 12/31/94	7%
1/1/95 - 6/30/95	8%	7/1/95 - 12/31/95	9%
1/1/96 - 6/30/96	9%	7/1/96 - 12/31/96	9%
1/1/97 - 6/30/97	9%	7/1/97 - 12/31/97	9%

Duration of Average Collection Case by EDD		PENALTY	INTEREST
Collections 0 - 90 Days	56%	\$28,822,177.15	\$595,197.70
Collections 91 -180 Days	18%	\$9,264,271.23	\$382,627.09
Collections over 180 Days	26%	\$13,381,725.10	\$1,120,719.48
TOTAL ANNUAL PENALTY & INTEREST	100%	\$51,468,173.48	\$2,098,544.27

Year	Interest Refunded	Interest Earned on Refunded Interest	Total \$ to be Refunded
1997	\$2,098,544.27	\$175,753.08	\$2,274,297.35
1996	\$2,098,544.27	\$190,472.40	\$2,289,016.67
1995	\$2,098,544.27	\$206,424.47	\$2,304,968.74
1994	\$2,098,544.27	\$223,712.52	\$2,322,256.79
TOTAL	\$8,394,177.08	\$796,362.47	\$9,190,539.55

APPENDIX A - Page 2

CALCULATION OF POTENTIAL INTEREST REFUNDS BY EDD, 1990-93

Section 1112.5 UIC Penalty (from EDD)	\$4,177,680.59
Section 1114 UIC Penalty (estimated)	\$22,623,016.00
TOTAL PENALTY	\$26,800,696.59

TOTAL REFUNDS DUE	Amount
1994 - 1997	\$9,190,539.55
1990 - 1993	\$9,179,822.65
TOTAL	\$18,370,362.19

EDD's Average Annual Interest Rate	9.63%
1/1/90 - 6/30/90 11%	7/1/90 - 12/31/90 11%
1/1/91 - 6/30/91 11%	7/1/91 - 12/31/91 10%
1/1/92 - 6/30/92 10%	7/1/92 - 12/31/92 9%
1/1/93 - 6/30/93 8%	7/1/94 - 12/31/94 7%

Duration of Average Collection Case by EDD		PENALTY	INTEREST
Collections 0 - 90 Days	56%	\$15,008,390.09	\$356,192.27
Collections 91 -180 Days	18%	\$4,824,125.39	\$228,980.75
Collections over 180 Days	26%	\$6,968,181.11	\$670,687.43
TOTAL ANNUAL PENALTY & INTEREST	100%	\$26,800,696.59	\$1,255,860.45

Year	Interest Refunded	Interest Earned on Refunded Interest	Total \$ to be Refunded
1993	\$1,255,860.45	\$732,927.38	\$1,988,787.83
1992	\$1,255,860.45	\$924,447.65	\$2,180,308.10
1991	\$1,255,860.45	\$1,134,411.32	\$2,390,271.77
1990	\$1,255,860.45	\$1,364,594.49	\$2,620,454.94
TOTAL	\$5,023,441.80	\$4,156,380.85	\$9,179,822.65

APPENDIX B

Penalty Provisions of the Unemployment Insurance Code:

Section 1112, Unemployment Insurance Code – Requires employers who fail to make timely payment of taxes to pay a penalty of 10% of the taxes owed.

Section 1112.5, Unemployment Insurance Code – Requires employers to pay a penalty of 10% of the tax required to be paid by the report if the employer fails to file the report.

Section 1114, Unemployment Insurance Code – Requires employers who fail to file a report of wages paid to employees to pay a penalty of \$10 per unreported employee for failure to file without good cause. EDD must provide a 15-day notice before charging the penalty. The penalty may be waived for good cause.

Article 8 of Chapter 4, or Part 1 of Division 1, (commencing with Section 1126) Unemployment Insurance Code – Allows various penalties for failure to comply with tax payment or reporting requirements. These penalties are charged when EDD completes an audit or an investigation of a business.

Division 6, Unemployment Insurance Code – Provides various requirements and penalties relative to personal income tax withholding by employers and remittance and reporting to EDD.

Interest Provisions of the Unemployment Insurance Code:

Section 1113, Unemployment Insurance Code – Allows interest to be charged on taxes owed. This applies to employers who owe taxes but are not audited or investigated. Typically, these employers file returns but don't pay the taxes on time. Section 1113 applies to tax delinquency penalties charged prior to January 1, 1994, and has never applied to report delinquency penalties.

Section 1129, Unemployment Insurance Code – Allows interest to be charged on Article 8 assessments. There are no report delinquency penalties under Article 8, consequently, Section 1129 applies to tax delinquency penalties charged prior to January 1, 1994.

Summary of Penalty and Interest Provisions:

EDD has never had authority to charge interest on report delinquency penalties. Additionally, since January 1, 1994 has had no authority to charge interest on any penalties.

APPENDIX C

LEGISLATIVE COUNSEL OPINION #24964

LEGISLATIVE COUNSEL
OF CALIFORNIA

Bion M. Gregory

Sacramento, California
December 12, 1997

Honorable Don Perata
3152 State Capitol

Unemployment Insurance Contributions:
Interest Charges - #24964

Dear Mr. Perata:

QUESTION NO. 1

Does Section 1113 of the Unemployment Insurance Code or any other provision of law authorize the Employment Development Department to charge interest on penalties imposed on employers under Section 1112 of the Unemployment Insurance Code for failure to pay unemployment insurance contributions or under Section 1112.5 or 1114 of the Unemployment Insurance Code for failure to file certain related reports within the time required?

OPINION NO. 1

Neither Section 1113 of the Unemployment Insurance Code nor any other provision of law authorizes the Employment Development Department to charge interest on penalties imposed on employers under Section 1112 of the Unemployment Insurance Code for failure to pay unemployment insurance contributions within the time required. Further, Section 1113 of the Unemployment Insurance Code does not apply to Section 1112.5 or 1114 of the Unemployment Insurance Code because Section 1113 of the Unemployment Insurance Code applies only to cases where an employer fails to pay required contributions, whereas Sections 1112.5 and 1114 of the Unemployment Insurance Code apply only to cases where an employer fails to file certain reports related to those contributions and associated wages.

ANALYSIS NO.1

By way of background, Part 1 (commencing with Section 100) of Division 1 of the Unemployment Insurance Code (Foot Note#1) sets forth the state's unemployment compensation law. Article 7 (commencing with Section 1110) of Chapter 4 of Part 1 of Division 1 (hereafter Article 7) governs the payment of reported (Foot Note#2) employer and worker unemployment insurance contributions.

With respect to the "penalty" provisions under consideration, Section 1112 provides as follows:

"1112. (a) Any employer who without good cause fails to pay any contributions required of him or her or of his or her workers, except amounts assessed under Article 8 of this chapter, within the time required shall pay a penalty of 10 percent of the amount of those contributions.

"(b) Any employer required to remit payments by electronic funds transfer pursuant to Section 13021, who remits those amounts by means other than electronic funds transfer shall pay a penalty of 10 percent of the amount of those contributions." (Emphasis added.)

Section 1112.5 provides as follows:

"1112.5. (a) Any employer who without good cause fails to file the reports required by subdivision (a) of Section 1088 and subdivision (a) of Section 13021 within 60 days of the time required under subdivision (a) of Section 1110 shall pay a penalty of 10 percent of the amount of contributions and personal income tax withholding required by this report. This penalty shall be in addition to the penalties required by Sections 1112 and 1126.

"(b) For purposes of subdivision (a), the amount of contributions and personal income tax required by the report of contributions shall be reduced by the amount of any contributions and personal income tax paid on or before the prescribed payment dates." (Emphasis added.)

Section 1114 provides as follows:

"1114. (a) Any employer who, without good cause, fails to file within 15 days after service by the director of notice pursuant to Section 1206 of a specific written demand therefor, a report of wages of each of his or her workers required by this division, shall pay in addition to other amounts required, for each unreported wage item a penalty of ten dollars (\$10).

"(b) Any employer required by this division to file a report of wages of each of his or her workers on magnetic media as prescribed by subdivision (f) of Section 1088, who, without good cause, instead files a report of wages on paper or in another form, shall pay in addition to other amounts required, for each wage item a penalty of ten dollars (\$10)." (Emphasis added.)

Thus, under Section 1112, if an employer fails, in the absence of good cause, to submit to the Employment Development Department within the time required under Article 7, all required employer and worker unemployment insurance contributions, except amounts assessed under Article 8 (commencing with Section 1126) of Chapter 4 of Part 1 (hereafter Article 8), (Foot Note#3) the department may impose on that employer a penalty equal to 10 percent of the overdue contributions. Further, under Section 1112.5, if an employer fails, in the absence of good cause, to file within the time specified the reports required under subdivision Section 1088 and under subdivision (a) of Section 13021, (Foot Note#4) the department may impose an additional penalty equal to 10 percent of the contributions and personal income tax withholding required thereunder. Further, under Section 1114, if an employer fails, in the absence of good cause, to file within the time specified a report of wages of each of his or her workers upon demand by the Director of Employment Development, or, if an employer who is required to file such information on magnetic media but instead, in the absence of good cause, files the information in another form, the department may impose an additional penalty for each wage item of \$10.

With respect to the "interest" provision under consideration, Section 1113 provides as follows:

"1113. Any employer who fails to pay any contributions required of him or of his workers, except amounts assessed under Article 8 (commencing with Section 1126), within the time required shall become liable for interest on such contributions at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the date of delinquency until paid." (Emphasis added.)

Thus, if an employer fails to pay any required contributions within the time required, the department may, under Section 1113, charge the employer interest, pursuant to Section 19521 of the Revenue and Taxation Code, (Foot Note#5) on those overdue contributions.

With this background in mind, we first consider whether the department may, under Section 1113, charge interest on the 10 percent penalty imposed under Section 1112 for failure to pay required contributions within the required time. In this regard, while both Sections 1113 and 1112 apply in cases where an employer fails to pay required contributions, we must consider whether the 10 percent penalty imposed under Section 1112 is included within the definition in Section 1113 of "any contributions required" of the employer or the employer's workers, since Section 1113 does not expressly authorize the charging of interest on that 10 percent penalty or on any other penalty that may be imposed.

Although there is no case law interpreting Section 1113 with regard to this issue, when the language of a statute is clear, a court interpreting it should follow its plain meaning (Great Lakes Properties, Inc. v. City of El Segundo, 19 Cal. 3d 152, 155) except in the case of uncertainty (Holder v. Superior Court, 269 Cal. App. 2d 314, 317). In this case, reported contributions required to be paid under Article 7 (of which Section 1113 is a part) are determined and defined solely on the basis of wages paid by the employer, and not with respect to penalties that may be imposed thereon (see, for example, Section 1110, which specifies for purposes of payment under Article 7, contributions required under Sections 976, 976.5, and 976.6 (employers), and under Section 984 (workers), all of which are solely based on wages paid by the employer; see also Section 906, which provides a general wage-based definition of "contributions paid on his own behalf" applicable to all of Chapter 4 of Part 1, including Article 7). Thus, we think that the meaning of "contributions required" in Section 1113 is clear in not including penalties imposed under Section 1112 on those contributions.

Moreover, where a statute with reference to one subject contains a vital word, omission of that word from a similar statute on the same subject is significant to show a different intention (Gonzales & Co. v. Department of Alcoholic Bev. Control, 151 Cal. App. 3d 172, 178), and that word should not be inferred where it has been excluded (People v. Bartlett, 226 Cal. App. 3d 244, 252). In this case, Article 7 includes several provisions where distinct references are made in the same section to "contributions" and "penalties," thereby supporting the conclusion that when the Legislature intended to include penalties within the operative effect of a given section in Article 7 dealing with contributions, it did so by expressly referencing "penalties" (see Secs. 1110.1, 1110.6, 1113.1, and 1116). Thus, we think that the lack of an express reference to "penalties" in Section 1113 is further evidence of the Legislature's intent to exclude penalties imposed under Section 1112 from the operative effect of that section.

We next consider whether the department may, under Section 1113, charge interest on the penalties imposed under Section 1112.5 or 1114 for failure to file certain required reports within the required time. In this regard, based upon the plain meaning of those statutes, we think that Section 1113 does not

apply to Section 1112.5 or 1114 because Section 1113, by its terms, authorizes the charging of interest only in cases where an employer fails to pay required contributions, whereas Section 1112.5 or 1114 impose penalties not for the failure to pay required contributions (as under Section 1112), but merely for the failure to file the reports related to those contributions and associated wages. Thus, we think that any further analysis of whether the penalties imposed under Section 1112.5 or 1114 are included within the definition in Section 1113 of "any contributions required" is unnecessary.

Finally, we are not aware of any other provision of law that authorizes the Employment Development Department to charge interest on penalties imposed pursuant to Section 1112, 1112.5, or 1114 on employers.

Accordingly, it is our opinion that neither Section 1113 of the Unemployment Insurance Code nor any other provision of law authorizes the Employment Development Department to charge interest on penalties imposed on employers under Section 1112 of the Unemployment Insurance Code for failure to pay unemployment insurance contributions. It is our further opinion that Section 1113 of the Unemployment Insurance Code does not apply to Section 1112.5 or 1114 of the Unemployment Insurance Code because Section 1113 applies only to cases where an employer fails to pay required contributions, whereas Sections 1112.5 and 1114 of the Unemployment Insurance Code apply only to cases where an employer fails to file certain reports related to those contributions and associated wages.

QUESTION NO. 2

Prior to the repeal of Section 19269 of the Revenue and Taxation Code by Chapter 31 of the Statutes of 1993, did the Employment Development Department have the authority to charge interest on penalties imposed under Section 1112, 1112.5, or 1114 of the Unemployment Insurance Code?

OPINION NO. 2

Prior to the repeal of Section 19269 of the Revenue and Taxation Code by Chapter 31 of the Statutes of 1993, the Employment Development Department had the authority to charge interest on penalties imposed under Section 1112 of the Unemployment Insurance Code, but did not have the authority to charge interest on penalties imposed under Section 1112.5 or 1114 of the Unemployment Insurance Code.

ANALYSIS NO. 2

As discussed in Analysis No. 1, Section 1113 authorizes the Employment Development Department to charge employers interest on overdue contributions, as follows:

"1113. Any employer who fails to pay any contributions required of him or of his workers, except amounts assessed under Article 8 (commencing with Section 1126), within the time required shall become liable for interest on such contributions at the adjusted annual rate and by the method established pursuant to Section 19521 of the Revenue and Taxation Code from and after the date of delinquency until paid." (Emphasis added.)

Since January 1, 1994, Section 1113 has provided that interest on those contributions shall be determined based on the rate and method established pursuant to Section 19521 of the Revenue and Taxation Code (see Secs. 65 and 83, Ch. 31, Stats. 1993). Section 19521 was added by Chapter 31 of the Statutes of 1993 and became effective on January 1, 1994 (see Secs. 26 and 83, Ch. 31, Stats. 1993). As discussed in footnote 5 in Analysis No. 1, Section

19521 of the Revenue and Taxation Code provides for the determination of the appropriate interest rate in accordance with Section 6621 of the Internal Revenue Code, subject to specified modifications. However, Section 19521 does not provide any authority for the Employment Development Department to charge interest on penalties.

Prior to January 1, 1994, Section 1113 instead referenced Section 19269 of the Revenue and Taxation Code with respect to determining the "rate and method" of interest on overdue contributions. Section 19269 was repealed by Chapter 31 of the Statutes of 1993, as of January 1, 1994 (see Secs. 22 and 83, Ch. 31, Stats. 1993). Prior to its repeal, Section 19269 of the Revenue and Taxation Code provided as follows:

"19269. (a) The rate established under this section (referred to in other code sections as 'the adjusted annual rate') shall be determined in accordance with the provisions of Section 6621 of the Internal Revenue Code, except that:

"(1) The overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be equal to the underpayment rate determined under Section 6621(a)(2) of the Internal Revenue Code; and

"(2) The determination specified in subsection (b) of Section 6621 shall be modified to be determined semiannually as follows:

"(A) The rate for January shall apply during the following July through December, and

"(B) The rate for July shall apply during the following January through June.

"(b) (1) For purposes of this part, Part 11 (commencing with Section 23001), and any other provision of law referencing this method of computation, in computing the amount of any interest required to be paid by the state or by the taxpayer, or any other amount determined by reference to that amount of interest, that interest and that amount shall be compounded daily.

"(2) Paragraph (1) shall not apply for purposes of computing the amount of any addition to tax under Section 18682 or 25951.

"(3) This subdivision shall apply to interest accruing after June 30, 1983.

"As of June 30, 1983. all taxes. assessed penalties or additions to tax, and interest (whether or not assessed) shall be added together to determine the amount to be carried over on which daily interest shall be charged in accordance with this subdivision.

"(c) Section 6621(c) of the Internal Revenue Code, relating to increase in underpayment rate for large corporate underpayments, shall be modified as follows:

"(1) The applicable date shall be the 30th day after the earlier of either of the following:

"(A) The date on which the proposed assessment is issued.

"(B) The date on which the notice and demand is sent.

"(2) This subdivision shall apply for purposes of determining interest for periods after December 31, 1991." (Emphasis added.)

In contrast to Section 19521 of the Revenue and Taxation Code, Section 19269 of the Revenue and Taxation Code contains language relative to charging of interest on penalties. It provided that, on and after June 30, 1983, all taxes, assessed penalties, or additions to tax, and interest shall be added together to determine the amount to be carried over on which daily interest is to be charged. The question is whether this reference, prior to its repeal, provided authority for the Employment Development Department to charge employers interest on penalties on overdue contributions under Section 1112.

Subdivision (b) of Section 19269 of the Revenue and Taxation Code contained specific language indicating that its provisions were intended to apply not only for certain purposes under the Revenue and Taxation Code, but also to "any other provision of law referencing this method of computation." At the time Section 19269 of the Revenue and Taxation Code was in effect, Section 1113 provided that interest on delinquent employer contributions was to be determined among other things "by the method established pursuant to Section 19269 of the Revenue and Taxation Code." Therefore, Section 1113 is one of those "other provisions of law" referenced in subdivision (b) of Section 19269 of the Revenue and Taxation Code, and we think the Legislature intended for the method established in Section 19269 of the Revenue and Taxation Code to be applied to Section 1113 interest calculations. We also think it is reasonable to assume that the practice of charging interest on a combined sum of delinquent contributions and penalties assessed on those contributions is a "method" of charging interest, as opposed to other methods, such as not including penalties in the amount subject to interest.

Accordingly, while Section 1113 contains no express language authorizing penalties on delinquent contributions to be included in the amount on which interest is charged, Section 1113 read together with Section 19269 of the Revenue and Taxation Code did authorize assessed penalties to be included in this amount. To ascertain legislative intent, the courts should construe a statute with reference to the whole system of law of which it is a part, so that all may be harmonized and have effect (People v. Ruster, 16 Cal. 3d 690, 696). This authority existed until Section 19269 of the Revenue and Taxation Code was repealed on January 1, 1994, and replaced with Section 19521 of the Revenue and Taxation Code, which section does not contain any reference to a method of calculating interest due by combining the delinquent contributions with penalties assessed on those contributions. (Foot Note#6)

The remaining question is whether the penalties provided for under Section 1112 are "assessed penalties," as those words are used in former Section 19269 of the Revenue and Taxation Code. Under Section 19269 of the Revenue and Taxation Code, interest that was due from the taxpayer, whether or not assessed, was also to be added to any taxes, assessed penalties, or additions to tax that cumulatively determine the amount upon which subsequent daily interest was to be charged. Therefore, while the amount of interest did not need to be "assessed" in order to become part of the base amount upon which subsequent interest was charged, penalties did need to be "assessed" in order to become part of that base amount. In engaging in statutory interpretation, courts are to accord words their usual, ordinary, and common sense meaning, based on the language used by the Legislature and the evident purpose for which the statute was adopted (In re Rojas, 23 Cal. ad 152, 155). We think the usual, ordinary, and common sense construction of "assessed" in this context required the Employment Development Department to take some action to calculate the amount of penalties due, and to make a demand on the employer for the amount of the penalties, before those penalties would be

eligible to be included in the base amount upon which subsequent interest could be charged.

We next examine whether the Employment Development Department had authority prior to January 1, 1994, to charge interest on penalties imposed under Section 1112.5 or 1114. As discussed in Analysis No. 1, it is our opinion that Section 1113 (the "interest" provision) does not apply to the penalties imposed under Section 1112.5 or 1114 because Section 1113, by its terms, authorizes the charging of interest only in cases where an employer fails to pay the required contributions, whereas Sections 1112.5 and 1114 impose penalties not for the failure to pay contributions (as under Section 1112), but merely for the failure to file certain reports related to those contributions and associated wages.

Accordingly, it is our opinion that prior to the repeal of Section 19269 of the Revenue and Taxation Code by Chapter 31 of the Statutes of 1993, the Employment Development Department had the authority to charge interest on penalties imposed under Section 1112 of the Unemployment Insurance Code, but did not have the authority to charge interest on penalties imposed under Section 1112.5 or 1114 of the Unemployment Insurance Code.

Very truly yours,

Bion M. Gregory
Legislative Counsel

By
L. Erik Lange
Deputy Legislative Counsel

LEL:sjm

Foot Notes:

1) All further section references are to the Unemployment Insurance Code, unless otherwise indicated.

2) Under subdivision (a) of Section 1088, each employer is required to file with the Director of Employment Development, along with corresponding payments, a report of employer contributions and an accompanying report of wages paid to his or her workers, as specified. Under subdivision (b) of that section, each employer is also required to file with the director a report of worker contributions, as specified.

3) Article 8 authorizes the Director of Employment Development to make certain assessments for unemployment insurance contributions against employers who, among other things, fail to make required returns or reports (see Sec. 1126), and in certain cases, to charge penalties and interest on those assessments (see Secs. 1126.1, 1127, 1128, 1128.1, 1129, 1135, 1142, 1143, and 1144).

4) As previously stated in footnote 2 of this opinion, under subdivision (a) of Section 1088, each employer is required to file with the Director of Employment Development, along with corresponding payments, a report of employer contributions and an accompanying report of wages paid to his or her workers, as specified. Under subdivision (a) of Section 13021, each employer required to withhold income taxes on wages paid to employees (see Sec. 13020) must file a withholding report and a report of wages, as specified, along with the taxes required to be withheld.

5) Section 19521 of the Revenue and Taxation Code provides that the adjusted annual rate of interest shall be determined in accordance with Section 6621 of the Internal Revenue Code (26 U.S.C.A. Sec. 6621), subject to specified modifications. Section 6621 of the Internal Revenue Code provides, among other things, for an "underpayment rate" of interest equal to the federal short-term rate, as defined, plus 3 percentage points.

6) Chapter 31 of the Statutes of 1993, the act that repealed Section 19269 of the Revenue and Taxation Code and enacted Section 19521 of that code, also enacted Section 19106 of that code, which provides for the imposition of interest on certain penalties (see Art. 6 (commencing with Sec. 19101) and Art. 7 (commencing with Sec. 19131), Ch. 4, Pt. 10.2, Div. 2, R.& T.C.). However, Section 19106 of the Revenue and Taxation Code does not contain any language making it applicable to penalties imposed under the Unemployment Insurance Code, and we found no section of the Unemployment Insurance Code that refers to Section 19106 of the Revenue and Taxation Code.

APPENDIX D

TIMELINE OF STAFF RESEARCH

August 28, 1997: Staff visited EDD for a briefing to gather general information about the tax program as well as job training and welfare-to-work efforts.

September 11, 1997: Staff received additional information on tax audit and compliance enforcement efforts.

Week of October 14: Staff asked EDD for data on penalties charged under Sections 1112 and 1112.5 of the Unemployment Insurance Code (UIC). EDD said that it does not track the duration that the penalties remain unpaid but could provide the dollar amount and number of penalties charged.

October 23, 1997: Staff received an oral opinion from Legislative Counsel that Section 1113 UIC does not allow EDD to charge interest on Section 1112 and 1112.5 penalties.

October 27, 1997: Staff received a draft of the format of the report of the information EDD will provide.

October 30, 1997: Staff received a written opinion from Legislative Counsel that Section 1113 UIC does not allow EDD to charge interest on Section 1112 and 1112.5 penalties.

November 17, 1997: Staff received Section 1112 and 1112.5 penalty data from EDD. EDD stated that they are not charging interest on Section 1112.5 penalties.

November 17, 1997: Staff requested additional information from EDD on Section 1113 penalty data, and information on the number of employers charged the tax and the duration of the liabilities.

November 18, 1997: Staff asked Legislative Counsel for an opinion addressing SB 3 (Greene), 1993, and its impact on EDD's authority to charge interest on penalties.

November 20, 1997: Staff received an oral opinion from Legislative Counsel that an argument could be made that, prior to SB 3, EDD had authority in the Revenue & Taxation Code to charge interest on penalties. However, since January 1, 1994, (when SB 3 took effect) EDD has had no authority to charge interest on Section 1112, 1112.5, or 1114 penalties.

November 24, 1997: Staff received preliminary information from EDD in response to the November 17 request. Staff also met with EDD staff to discuss whether the law allows EDD to charge interest on Section 1112 and 1114. EDD stated that the law allows interest to be charged on penalties, and it does not intend to issue refunds. EDD also said they had no hard data but will try to get it to staff by December 15.

November 25, 1997: Staff requested additional information from EDD relative to EDD's history and awareness of problems with Section 1113 and EDD's authority to charge interest on penalties.

December 4, 1997: Staff received an oral opinion from Legislative Counsel that EDD has never had authority to charge interest on report delinquency penalties and since January 1, 1994, has had no authority to charge interest on tax delinquency penalties under Sections 1113 or 1129 UIC.

December 5, 1997: Requested additional information from EDD on Section 1129 and Division 6 penalties and interest charges.

December 8, 1997: Staff discussed with EDD the amount of Section 1114 penalties which have been charged annually. EDD agreed that Section 1114 was likely greater than Section 1112.